

## **AN ANALYSIS OF LATE PAYMENT CHARGE ON DEFAULTERS IN ISLAMIC BANKING AND FINANCE: A MALAYSIAN PERSPECTIVE**

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*Under conventional banking, a debtor who defaults in instalment payment or pays later than the agreed time, will have to pay a charge of interest. However, in Islamic banking and finance, such interest is clearly caught by the prohibition of riba. As an alternative to the charge of interest, Islamic financial institutions impose late payment charge on defaults by its customers. This paper analyses the Malaysian experience in imposing late payment charge for defaults arising out of Islamic banking and finance instruments under the present statutory framework. Basis for allowing late payment charge and types of defaulters were also examined. At the end, this paper suggested some suggestions to ensure the administration of late payment charge is more Shari'ah compliant.*

**Keywords:** *Islamic banking and finance, defaults in repayment, late payment charge, Shari'ah compliance.*

### **INTRODUCTION**

It is a cardinal rule that a party to a contract must fulfil his obligation under the contract. In contracts, time is usually of the essence. Thus, any party to a contract must observe any time clause stated in the contract. He must perform his obligation under the contract according to the time clause. If he is a debtor, he is obliged to pay

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the debt to his creditor within the time stipulated in the contract. Likewise, if he is a tenant he must pay the rent to the landlord within the agreed time. However, if the debtor or tenant in the above situations does not pay within the prescribed period or pay after the period, he has breached the contract. He must face the consequences of the breach as stated by the contract itself or legal action according to the law of contract. In conventional banking a debtor who defaults in instalment payment or pays later than the agreed time, will have to pay a charge of interest. However in Islamic banking and finance, such interest is clearly caught by the prohibition of *riba*.<sup>1</sup> Thus to avoid *riba* in managing the issue of late payment by its customers or debtors, an Islamic financial institution (IFI) may impose late payment charge. This article shall discuss the issue of late payment charge according to the Shari'ah point of views and the practice of IFIs in Malaysia; able and poor debtors; and suggestions for better administration of late payment charge.

## LATE PAYMENT CHARGE

### Late Payment Charge : Shari'ah Point of View

The Shari'ah puts emphasis on the fulfilment of promise. Once parties to a contract put their agreed terms into the contract, both the parties are under obligation to comply with the terms. The authorities for this obligation can be found in the Quran which says, "O ye who believe! Fulfil (all) obligations..."<sup>2</sup> and "... fulfil (every) engagement, for (every) engagement will be enquired into (on the Day of Reckoning)".<sup>3</sup>

The Sunnah also provides the authority on this matter. It regards a person who breaks his promise as a hypocrite. This can be found in a hadith where 'Abdullah bin 'Amr narrated that the Prophet PBUH said:

*Whoever has (the following) four characters will be a hypocrite, and whoever has one of the following four characteristics will have one characteristic of hypocrisy until he gives it up. These are: (1) Whenever he talks, he tells a lie; (2) whenever he makes a promise, he breaks it (emphasis is added); (3) whenever he makes a covenant he proves treacherous; (4) and whenever he quarrels, he behaves impudently in an evil insulting manner.*<sup>4</sup>

It is clear from the above primary sources of the Shari'ah that fulfilling a promise, engagement or contract demands fulfilment on every Muslim. The obligation includes any mutually agreed term on the customer or purchaser to pay in lump sum or instalments within the agreed time. In fact any party who breaks such an obligation is regarded as a hypocrite and sinful.

In addition to the above obligation to fulfil a promise, the Shari'ah further provides the effects of wilful failure to fulfil such promise. Firstly, when a purchaser wilfully fails to fulfil his obligation to pay an instalment within the prescribed time as stipulated in the contract, not only he has breached the contract but also has, according to the Shari'ah, caused injustice to the seller. This is based on the authority of a hadith from Abu Huraira who narrated that Prophet Muhammad (s.a.w.) stated, "Procrastination (delay) in repaying debts by a wealthy person is injustice".<sup>5</sup> Secondly, the Shari'ah prescribes punishment and disgrace on a person who caused such injustice. This is based on a hadith where the Prophet (s.a.w.) said, "Delay in payment on the part of one who possesses means makes it lawful to dishonour and punish him."<sup>6</sup> Based on the hadith there are two types of implication of a defaulting rich debtor: to dishonour or punish him. 'To dishonour' him means to speak roughly to him and 'to punish' him means to put him into prison.<sup>7</sup>

Apart from the punishments of dishonouring the debtor and imprisonment, scholars have come out with several other punishments, which may be meted out against a debtor or judgment debtor who wilfully refuses to pay. The most important one is late payment charge or penalty.<sup>8</sup>

*Qiyas* (analogy) is another authority, which lends support to the permissibility of late payment charge. According to this legal source, late payment is equivalent to *ghashb* (unlawful taking or retention) of other's property. Both acts share the same '*illah*' (cause of ruling) i.e. causing injustice by preventing the lawful owner from dealing with his property. By virtue of analogy the ruling for late payment is similar to that of the act of unlawfully taking other's property. Thus late payment by a wealthy debtor is forbidden. Another point to note is that a person who unlawfully takes or retains possession of other's

property is liable for any loss of the property or its usufruct. Similarly, a late payer is liable because he causes an IFI to incur loss of opportunity to use the fund for other profitable ventures.<sup>9</sup> For any such loss the IFI is permitted to be compensated by the late payer.

Another authority is an Islamic maxim which means, 'Harm may neither be inflicted nor be reciprocated'.<sup>10</sup> This maxim must be read together with the second maxim, 'Harm or wrong is to be undone'.<sup>11</sup> When a person causes harm to the property of another person, the first maxim does not permit the latter to cause similar harm to the property of the former. Instead, by virtue of the second maxim the latter is allowed to ask for compensation to the extent of the loss to the property that he has incurred.<sup>12</sup>

Now, there is no doubt that the above legal authorities in the Shari'ah make fulfilment of a promise as an obligation and permit punishment to be imposed on defaulting debtors who have means to repay debts. Does this ruling apply to late payment on the part of judgment debtors of IFIs who have means to repay the judgment debt as well? It is submitted that the ruling does apply to the judgment debtors also. The reason is that the position of a debtor and a judgment debtor are similar as they are under obligation to pay though the obligation of the debtor is created by a contract and that of the judgment debtor by a judgment. Moreover in most cases the judgment debt is actually the debt amount that the judgment debtor failed to pay according to the terms of the contract. In other words, though a judgment debtor is bound by the judgment, the duty to pay under the judgment stems out from the original duty to pay under the contract. In conclusion late payment on the part of a judgment debtor who has the means to pay is also injustice and liable for punishment according to the Shari'ah.

### Practice of IFIs in Malaysia

In order to resolve issues of late payments by customers or debtors, the Shari'ah Advisory Council of the Central Bank of Malaysia passed a resolution on the permissibility of late payment charge based on several Shari'ah authorities.<sup>13</sup> As such, IFIs in Malaysia are allowed to impose late payment charge in cases of defaults by their customers

or debtors. The late payment charge is allowed based on the principles of *gharamah* (penalty or fine) and *ta'widh* (compensation).<sup>14</sup> Meaning when a late payment charge is imposed by an IFI on the customer or debtor, the charge actually includes both penalty and compensation.

The application of late payment charge against the debtors is subject to several conditions laid down by the Central Bank of Malaysia. Firstly, *ta'widh* (compensation) is imposed on late payment in loans and contracts of exchange, such as tenancy and sale and purchase.<sup>15</sup> Secondly, *ta'widh* can only be imposed when the time for repayment as agreed by both the parties expires.<sup>16</sup> Thirdly, IFIs may treat *ta'widh* as income on the ground that it is compensation for the actual loss suffered by the IFIs.<sup>17</sup> Fourthly, *gharamah* (penalty) is not considered an income to the IFIs but must be distributed by the IFIs to certain charitable organisations.<sup>18</sup> Fifthly, the delay in paying must be due to negligence on the part of the debtor.<sup>19</sup> Sixthly, the determination of compensation shall be made by a third party ie the Central Bank of Malaysia.<sup>20</sup>

Regarding late payment in judgment debts, the Council also passed a resolution<sup>21</sup> that a judge may impose a late payment charge on a judgment debtor in cases of Islamic banking and *takaful*. Like late payment charge in debts, late payment charge in judgment debt is also based on the principles of *ta'widh* and *gharamah*. The application of late payment charge in judgment debts must be subject to the following conditions. Firstly, *ta'widh* must be not more than the actual loss suffered by the judgment creditor.<sup>22</sup> Secondly, the judge can impose late payment charge at a rate allowable by the relevant procedural rules.<sup>23</sup> Irrespective of whatever rate granted by the judge, the judgment creditor is only entitled for his *ta'widh* up to the amount of his actual loss. The balance if any must be paid to charitable organisations approved by the Central Bank of Malaysia.<sup>24</sup> This means if the late charge is fixed by the judge is 7% on the judgment debt and the actual loss of the judgment creditor due to the late payment is 5%, the balance of 2% is considered as penalty which must be paid to the charitable organisations. Thirdly, to determine the actual loss of the judgment creditor, reference should be made to 'annual average for overnight weighted rate' of Islamic money market of the

preceding year.<sup>25</sup> Fourthly, the amount of *ta'widh* claim must not be more than the amount of judgment debt.<sup>26</sup>

Since the practice of late payment charge applicable in Malaysia is based on the principles of *gharamah* (penalty) and *ta'widh* (compensation), it is relevant to examine both the principles separately from the Shari'ah point of view.

### ***Penalty (Gharamah) on Late Payment***

A penalty refers to monetary sum, which is imposed on the defaulting debtor for his failure to pay within time. It is defined as a fine, which is imposed for failure to pay within time, without having to prove actual loss.<sup>27</sup> However is penalty permissible in the Shari'ah? Islamic scholars are of conflicting views on its permissibility in cases of late payments by debtors.

The first view is against the permissibility of penalty on the ground that it is similar to *riba*. This is because penalty, like *riba*, comes into existence due to late payment.<sup>28</sup> It means additional amount that the debtor must pay, be it penalty or *riba*, is the result of late payment. It is no different with *riba al-nasiah* that was practised by Arab people during the pre-Islam period whereby they imposed additional sum on debtors who were unable to pay on the agreed date for any extension of time given. This type of *riba* was clearly prohibited by the Holy Qur'an<sup>29</sup> because the increment is due to extension of time given to the debtors.

On the other hand, the majority Islamic scholars regard penalty as permissible. The basis for their view is the above Quranic verses, which command the obligation to fulfil promise and the two hadiths<sup>30</sup>, which prescribe such a default as injustice and permits punishment on such a defaulter. Penalty may also be prescribed under *ta'zir* punishment<sup>31</sup>, which is based on the legal exertion of the judge or as fixed by other relevant bodies having the power to make law.<sup>32</sup> The permissibility of penalty may also be premised on the principle of *masalih mursalah* (unrestricted public interest), which is one of the secondary sources of Islamic law. This principle sees defaults by debtors having means to pay as serious problems and must therefore be restricted. This is important so that people at large will not be

allowed to take for granted the duty to pay their debts to IFIs within time when they have means to do so.<sup>33</sup>

Based on the above authorities, primary and secondary, and the views of the majority scholars, preference should be given to the first view i.e. penalty punishment is permissible against a debtor or judgment debtor who wilfully evades payment. The practice of the Central Bank of Malaysia in permitting IFIs to impose late payment charge based on the principle of penalty is indeed in line with the view of the majority of Islamic scholars.

In fact the permissibility of penalty can bring other advantages as well. It can instil a sense of discipline among debtors or judgment debtors to repay their debts within time according to their contract. Also, it may prevent them from using the prohibition of *riba* as an excuse for not repaying IFIs. Eventually such non-compliance of the contract, if not tackled properly will affect the development and progress of Islamic banking and finance industry.

### ***Penalty (Gharamah) on Late Payments: An Income to IFIs?***

Although it has been shown that penalty is permissible in cases of late payment of debt or judgment debt, there is another related issue, which is worth discussing herein. The issue is whether the penalty amount as imposed by IFIs in cases of late payment can be regarded as income for the IFI.

Islamic scholars who are in favour of the permissibility of penalty have a consensus opinion on this issue. They are of the opinion that proceeds from penalty imposed by the IFIs on defaulting customers cannot be regarded as income for the IFIs.

Instead the proceeds must be distributed by the IFIs to charities. This opinion is based on the view of majority scholars in the International Fiqh Academy on *murabahah*.<sup>34</sup> This opinion is also based on the principle of *iltizam at-tabarru'*, a principle recognised by the Maliki School. This principle means 'whoever undertakes to make some donation it becomes an obligation upon him'.<sup>35</sup> This self-imposed penalty concept is like a vow. According to Islamic scholars such a vow does not have legal effect on its maker but only moral or religious obligation. Thus it is not enforceable in the courts.

However, according to the Maliki School of law, such vow is enforceable by the court.<sup>36</sup>

The issue of *riba* does not arise here because the IFI is not allowed to take the donated sum as its income. In fact the IFI must act as an agent of the customer to distribute the sum to a third party, which must be a charitable organisation. *Riba* only arises if the sum is utilised by the IFI as its income. Regarding the charity to which the sum donated from penalty proceeds can be paid, it should be determined by the customer and specified in the contract.<sup>37</sup>

#### ***Ta'wid (Compensation) for loss due to Late Payment: Shariah Point of View***

Another principle relevant to the late payment charge is *ta'wid*. However, Islamic jurists have different views on whether an IFI is permitted to get compensated for the late payment on the part of its customer.

The first view is that it is not permissible for the IFI to claim compensation for its customers' late payment. The proponents of this view also do not permit imposing penalty on late payers. Their reason for not permitting compensation is similar to their reason for not permitting penalty. Compensation according to them is additional amount payable due to late payment and thus comes under the prohibition of *riba*. Another reason for not permitting compensation for late payment is that they do not recognise the concept of opportunity cost of money. That is because to them money has no definite return.<sup>38</sup>

On the other hand, the second view permits the IFI to claim compensation for loss due to late payment. This view sees a debtor's failure to pay within the agreed time as depriving the IFI from using the would-be income to generate profits. Such deprivation is injustice caused by the debtor to the IFI. This is in line with the authority of the previous Quranic verses on obligation to fulfil promise and the hadiths on punishment to wealthy debtors who default payment. Apart from the Holy Quran and the Sunnah, compensation is also permissible based on *Qiyas*, which is one of the main four legal sources in the Shariah. According to this source when a person takes another's

property illegally or refuses to return it to its lawful owner, the Shari'ah permits the owner to confiscate and sell that person's property to make good of the owner's right. In addition, that person must also be liable to the owner for any damage or loss of the property within that unlawful retention of the property.<sup>39</sup>

#### **Analysis on Late Payment**

Comparing the above Shari'ah position and the practice of IFIs in Malaysia, there is a similarity in the fact that late payment charge based on the principle of penalty (*gharamah*). The penalty amount is not regarded as income for the IFIs. Instead, proceeds from the late payment charges are treated as donation by the debtor and the IFIs are under obligation to distribute the proceeds to charities.

However, regarding the determination of charity there is difference in the application. We have noted that the Shari'ah position states that the customer or debtor shall decide which charity can receive the donated sum and therefore must be named in the contract. Whereas in Malaysia, the Shari'ah Advisory Council states that the Central Bank, being the regulator of all IFIs, shall have the right to determine which charity the donation should be distributed to.

As regards to late payment charge based on *ta'wid* (compensation) principle, the practice of IFIs in Malaysia and the directive of the Central Bank,<sup>40</sup> IFIs in Malaysia adopt the second view which permits them to be compensated for late payments on the part of their customer debtors. However the IFIs can only get the compensation subject to the amount of actual loss suffered by them as a result of the customer's default. If there is no loss they are not entitled to the compensation. The actual loss relevant may include costs of issuance of letters and notices, legal fees and other incidental costs or fees.<sup>41</sup>

In Malaysia the method of determining the rate of actual loss is regulated and supervised by the Central Bank. The determination of the rate of loss by a third party, especially by the Central Bank, may protect the IFIs' interest of getting compensated for the actual loss incurred due to late payment. In addition it may also protect the customer debtor's interest of not being charged arbitrarily by the IFIs.

Another point to note is that compensation for late payment of judgment debt is subject to a maximum rate fixed by the parties or the court. The IFIs are entitled to the actual loss amount only. The remaining sum out of the fixed rate must be distributed by the IFIs to charitable organisations approved by the Central Bank. This is because in Malaysia late payment charge combines both the principles of compensation (*ta'widh*) and penalty (*gharamah*).

### DEFAULT BY CUSTOMERS HAVING NO MEANS TO PAY

Debtors who are at default can be divided into two main categories: wealthy debtors and poor debtors.<sup>42</sup> While it is important that wilful refusal to pay on the part of wealthy debtors should be met with proper punishment, similar treatment must not be given to some debtors who have genuine reasons for not paying. Generally such debtors do not have available means or funds to pay their debts due to financial constraints. The following discussion will examine the position of debtors of the latter category in the Shari'ah and the practice of IFIs in Malaysia.

#### Position of the Shari'ah

The Shari'ah places a special treatment for a debtor who has no means to repay debts. In this regard the Holy Quran states, "If the debtor is in a difficulty, grant him time till it is easy for him to repay...".<sup>43</sup> This verse requires that such a debtor must be given certain easement of time until he can afford to pay. This can also be supported by the two hadiths<sup>44</sup> that expressly prescribe delay in repayment by a wealthy debtor as an injustice, which is punishable. Thus by implication of adverse inference, the two hadiths do not apply to a debtor who has no means to pay. In another hadith narrated by Abu Huraira that the Prophet (s.a.w.) said:

*'There was a person who gave loans to the people and said to his men: When an insolvent comes to you show him leniency that Allah may overlook our (faults). So when he met Allah, He overlooked his faults (forgave him).'*<sup>45</sup>

From the above authorities of the Quran and Sunnah, we can conclude that until such a debtor is able to repay, he should not be subject to penalty or other punishments as imposed on a wealthy

debtor who defaults. Instead, according to the Shari'ah, it is recommended upon a creditor to give a grace period to a debtor who has insufficient fund to pay his debt promptly. This may happen when the debtor lost his money or money that he has is only sufficient for the maintenance of his family and him. But the creditor is obliged to grant the grace period when it is proven that the debtor has no means to pay the debt based on the clear directive of the above Qura'nic verse.<sup>46</sup>

To qualify for the grace period, it is important that a debtor must have a genuine financial difficulty that prevents him from repaying his debt. A genuine financial difficulty refers to the state of inability to provide maintenance or fulfil an obligation with money but not with effort. The financial difficulty of the debtor can be proven by admission of a creditor that the debtor does not have means to pay his debt.<sup>47</sup> Secondly it can also be proven by testimony of two male witnesses that the debtor is having a grave financial difficulty and does not have any property to repay his debts.<sup>48</sup> Thirdly, it is proven by the oath of the debtor in addition to the testimony of two male witnesses.<sup>49</sup> Finally the financial difficulty can also be established by other circumstantial evidence.

It must be noted that when a debtor is proven to be in genuine financial difficulty, creditors must give him a grace period as underlined by the above Qur'anic verse. Thus they cannot enforce their contract against the debtor so long as his difficulty remains. But when there is evidence that he has new property or he receives money that he can use to repay, his duty to pay arises again. If he fails to pay it is an injustice, which can be subject to penalty or other punishments.

In cases where the debtor's financial difficulty is unlikely to change, the creditor is recommended by the Shari'ah to remit the debt in part or in full. This benevolent act is based on the second limb of the Qur'anic verse, which grants grace period to such debtor. The verse in full says, "If the debtor is in a difficulty, grant him time till it is easy for him to repay. But if ye remit it by way of charity, that is best for you if ye only knew."<sup>50</sup>

### Practice of IFIs in Malaysia

Instances of late payment and default are usually related to credit management policy of a bank. Each bank may have its own policy on credit management. However such policy must follow the guidelines or circulars on the same matters as issued by the Central Bank, the regulatory body of all banks in the country, from time to time.<sup>51</sup> Generally the policy on risk management of IFIs in Malaysia must be formulated so as to be consistent with the Islamic Financial Services Board (IFSB) Guiding Principles of Risk Management for Institutions (other than Insurance Institutions) Offering Only Islamic Financial Services (IFSB GPRM).<sup>52</sup>

In credit management under IFSB GPRM, a debtor or customer can be divided into two categories: an affluent customer and insolvent customer.<sup>53</sup> The former is the one who defaults or procrastinates in debt repayment, whereas the latter is the one who is unable to repay due to reasons recognised by the Shari'ah. Whilst the former's act is subject to penalty and/or late payment compensation, the latter is subject to the following measures:

- (a) Keeping updates with the financial status of such a debtor by maintaining frequent contacts with him;<sup>54</sup> and
- (b) Rescheduling or rearranging time frame for debt repayment by giving more time to him without any penalty or increase in the debt amount.<sup>55</sup>

Giving leniency to debtor may be abused by unscrupulous debtors to default in repayment. They may claim that they have financial difficulty. Moreover it is not easy to prove whether a debtor has no means to repay his debts or not. According to banking practice every debtor or customer is presumed to be able to pay debts unless he is declared bankrupt or insolvent.<sup>56</sup> Perhaps, the presumption may be used as a yardstick to determine inability to pay.

In Malaysia another way of determining an insolvent debtor is by recommendation of the Credit Counselling and Debt Management Agency (CCDMA)<sup>57</sup>. This agency was set up as part of the Central Bank of Malaysia and aimed at providing 'financial counselling and advice, debt management and financial education

to help Malaysians take control of their finances'.<sup>58</sup> Debtors who have financial difficulties should come forward to the agency whereby they must fulfil certain tests<sup>59</sup> and bring in evidence of their financial status. These tests are important to evaluate whether the debtors have genuine financial difficulties that prevent them from paying their debts. Once they are verified as having genuine financial difficulty, the agency with the agreement of the debtor will work out on an amount that the debtor is able to repay his debts. Usually such amount represents a reduction of monthly payment and/or an extension of the financing tenure. Once worked out, the amount would be regarded as the debtor's full and final proposal to pay. Then the agency will, with the proposal, approach the IFI with which the debtor has debt to negotiate for a reschedule of the debt. The proposal may be accepted by the IFI without any modification. It may also be accepted with modification but with the agreement of the debtor. In some cases the IFI may also accept only the principal amount of debt and remit any profit or interest charged on the principal.<sup>60</sup> In the whole process the agency acts as a counsellor and a middleman in the negotiation with the IFI.

### Analysis on Poor Debtors

Looking at the position of Shari'ah and the practice of IFIs in Malaysia, it is noted that the existence of an insolvent customer or debtor who has no fund to repay his debts is recognised under both the systems. Both the systems treat such a debtor with leniency whereby a grace period is given to him without any penalty or punishment being imposed on him.

The method of reschedule or rearrangement of debt repayments without any increment or penalty as adopted by IFIs is in line with the position of the Shari'ah on the matter. Except the charge of interest, this method is similarly practised in conventional banking where the amount of monthly repayment is reduced and more time to settle the debt is given to the debtor. Though the rescheduling method is not expressly mentioned in the Shari'ah legal texts, it is still in the spirit of giving leniency to such debtor as enjoined by the Qur'anic verse. Moreover it brings benefits for both the debtor and

the IFI. For the debtor, the debt is decreasing and his credit image is saved. Whereas for the IFI, the debt is being paid albeit slowly and its rate of non-performed loan is reduced. All these are achieved without compromising the prohibition of *riba*.

While the Shari'ah enjoins creditors to remit debts for insolvent debtor, IFIs do not always adopt such an approach. This is due to the fact that IFIs are business entities incorporated for profits. Being so, the IFIs have duty towards their depositors, shareholders and creditors to get profits. To remit debts would be prejudicial to the expectation of profits for these people. Such debt remittance may also be contrary to the memorandum and articles of association of the IFIs. Anyhow in some dire cases the IFIs may remit the profit charged on the principal.

What is important under both the systems is that the debtor must take proactive role in making the IFI know of his financial difficulty so that proper and prudent way out may be worked out for the benefits of both the debtor and the IFI. This may prevent unnecessary costs of notices of demand, reminders, summons and legal proceedings against the debtor. If he keeps silent on his financial condition, he will be treated like a defaulter without any genuine reasons and thus may incur the above costs. After all, the burden to prove his inability to repay should always be on his shoulder.

## CONCLUSION AND SUGGESTIONS

The Shari'ah law, like the civil law, regards defaults and late payment on the part of an able debtor as injustice against the creditor and permits punishment to be meted against such a debtor. As such, the majority of jurists view the late payment charge as permissible. Nonetheless the application of the charge must not be blanket coverage for all debtors, affluent and poor without discrimination. While the affluent debtors who default should be punished, the poor debtors must be treated leniently. In general, it can be concluded that the present practice of IFIs in Malaysia, relating to late payment charge, is already in the spirit of the Shari'ah. However there are some suggestions, which can be further implemented to make the practice more Shari'ah compliant.

Based on the above discussion, this article proposes two suggestions.

Firstly, the right to determine charitable organisations in the rank of priority should be given to the debtor or defaulting customer. This is because the debtor's agreement to donate, in the event he fails to pay within time, is actually a unilateral contract. It is up to the donor i.e. debtor or customer to choose which charity shall be paid when the failure occurs. Only if in the event where the debtor does not make any choice then the right to determine should be given to a third party, preferably one having regulatory or judicial power over the parties. A third party can be the Central Bank, like the practice in Malaysia, or the court or Shari'ah body. It is important the right to determine the charity is exercised by the donor or other independent third party and not the IFI, to avoid any conflict of interest in the distribution of the donation fund. If the distribution is left at the free will of every individual IFI, there is a tendency to channel the fund to a charity in which it has some affiliation.

In order to make this principle properly enforceable in the present legal framework, it is important that a provision must be inserted in the contract between the customer and IFI, which expressly refers to the customer's agreement to make donation. Such a provision may state to the effect that the customer agrees to make a commitment to pay within time under the contract and that if he fails to pay within the agreed time; he agrees to donate an agreed sum of money and appoints the IFI to distribute the said sum to charities.

Secondly, since the Shari'ah enjoins a poor debtor be treated leniently and it is difficult for the IFIs to determine whether a defaulter is genuinely poor, it is submitted a reference should be made to the CCDMA. In this regard such reference may be made by the defaulter himself or upon request of the IFIs. The CCDMA will determine whether he is actually poor or otherwise. It would be better if such a reference is made compulsory. Further such determination should be welcomed as it is made by an independent relevant third party. The CCDMA's determination should be accepted by the IFIs accordingly. Thus, an able debtor must be subject to late payment charge. Whereas, a poor debtor would be given some debt reduction;



or reasonable time to repay; or his debt would be restructured to enable him to pay less.

### Notes

1. The Presidency of Islamic Researches Ifta Call and Guidance (ed), The Holy Quran: English Translation of the Meanings and Commentary (King Fahd Holy Quran Printing Complex 1990 (1410 H)) Al-Baqarah (2) : verses 275 and 278.
2. The Presidency of Islamic Researches Ifta Call and Guidance (ed), *The Holy Quran*: Al-Maidah (Chap 5): verse 1 at 276.
3. *ibid*, al-Isra' (Chap 17): verse 28 at 786.
4. Abu Abdullah Muhammad bin Ismail bin Ibrahim bin al-Mughira al-Ja'fai, *Sahih Bukhari* (Muhammad Muhsin Khan tr, n.d.) Book 43, vol 3 no 639.
5. *ibid*, Book 41, vol 3 no 585.
6. Abu Dawud Sulayman ibn Ash'ath Azdi Sijistani, *Sunan Abu Dawud* (Ahmad Hasan tr, n.d.) Book 24, hadith no 3621.
7. *ibid*. See the opinion of Ibn al-Mubarak at the end of the hadith.
8. Zaharuddin Abd Rahman, 'Halalkah Penalti di Bank Islam?' ([www.zaharuddin.net](http://www.zaharuddin.net/perbankan-&-insuran/801-halalkah-penalti-di-bank-islam-.html), 12 February 2009) <<http://www.zaharuddin.net/perbankan-&-insuran/801-halalkah-penalti-di-bank-islam-.html>> accessed 4 July 2011. The writer also states other punishments which include blacklist, imprisonment, confiscation of passport, and seizure and sale of the debtor's properties.
9. Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance* (2 edn, Bank Negara Malaysia 2010) 131.
10. The maxim in Arabic reads, 'لا ضرر ولا ضرار'.
11. Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance* (n 9) 131. The maxim in Arabic reads, 'الضرر يزال'.
12. Abu Umar Faruq Ahmad and others, 'Shariah Maxims and Their Implications on Modern Financial Transactions' (2010) 6 Journal of Islamic Economics, Banking and Finance 75, 96.
13. For further details of the bases for its permissibility, see Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance* (n 9) Resolution No. 81, 129.

14. *ibid*.
15. *ibid*, 130.
16. *ibid*.
17. *ibid*.
18. *ibid*.
19. Shariah Advisory Council of Bank Negara Malaysia, *Shariah Resolutions of Bank Negara Malaysia* (1 edn, 2007), 29.
20. *ibid*.
21. Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance* (n 9), Resolution No.83, 133.
22. *ibid*.
23. Ord 42 r 12 of the Rules of Court 2012 provides the rate shall, if not mutually agreed by the parties, be determined by the Chief Justice from time to time. Under the old repealed law i.e. the Rules of High Court 1980 (Ord 44 r 18) provided that the maximum rate allowed was 8% which was similar to the applicable rate of interest.
24. Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance* (n 9) 134.
25. *ibid*.
26. *ibid*.
27. Mohammad Abdul Razaq al-Tabtabae, Al-Ta'widh 'an al-Dhararwa al-Gharamah 'ala al-Ta'khir fi al-Duyun: Dirasah Tatbiqiyah 'ala al-Mu'assasat al-Maliyyah al-Islamiyyah fi Daulati al-Kuwait, Al-Qadaya al-Mu'asarah fi al-Tamwil al-Islami: Munaqasyah fi al-Nadwah al-'Alamiyah li 'Ulama' al-Syari'ah 2006, Bank Negara Malaysia, 2008, p 91 cited in Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance* (n 9) 129.
28. Rahman, 'Halalkah Penalti di Bank Islam?' (n 8).
29. The Presidency of Islamic Researches Ifta Call and Guidance (ed), *The Holy Quran*, Ali 'Imran (3): 130.
30. See n 5 and n 6.
31. The other categories of punishment under Islamic criminal law are *hudud* punishment and *qisas* punishment. The punishment under these

categories is fixed by the main sources of the Shariah ie the Holy Quran and the *Sunnah*. Whereas *ta'zir* punishment is prescribed by the man-made law or discretion of the judge. Its punishment ranges from the least punishment of admonition until the severest punishment of death.

32. Rahman, 'Halalkah Penalti di Bank Islam?' (n 8).
33. *ibid*.
34. *ibid*.
35. *ibid*.
36. Al-Hattab, *Tahrir al-Kalam*, Beirut 1404H, p176 cited in Muhammad Taqi Usmani, *An Introduction to Islamic Finance* (Quranic Studies Publishers 2008) 138.
37. Usmani, *An Introduction to Islamic Finance* (n 36) 139-140.
38. *ibid*, 135.
39. Rahman, 'Halalkah Penalti di Bank Islam?' (n 8).
40. Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance* (n 9) 129.
41. *ibid* 131.
42. Bank Negara Malaysia, Guidelines on Musharakah and Mudharabah Contracts for Islamic Banking Institutions (Bank Negara Malaysia) <[http://www.bnm.gov.my/guidelines/01\\_banking/04\\_prudential\\_stds/15\\_mnm.pdf](http://www.bnm.gov.my/guidelines/01_banking/04_prudential_stds/15_mnm.pdf)> accessed 5 May 2014, para 5.2.
43. The Presidency of Islamic Researches Ifta Call and Guidance (ed), *The Holy Quran* Al-Baqarah (2): verse 280, 128.
44. Hadith by Abu Huraira who narrated that Prophet Muhammad stated, 'Procrastination (delay) in repaying debts by a wealthy person is injustice.' See al-Ja'fai, *Sahih Bukhari* (n 4) Book 43, vol 3 no 639. In another hadith the Prophet said, "Delay in payment on the part of one who possesses means makes it lawful to dishonour and punish him." See Sijistani, *Sunan Abu Dawud* (n 6) Book 24, no 3621.
45. Abul Husain Muslim bin al-Hajjaj al-Nisapuri, *Sahih Muslim* (— tr, n.d.) Bk 10 no 3793.
46. Ministry of Waqf and Islamic Affairs, *Al-Mawsu'ah al-Fiqhiyyah*, vol 14 (2 edn, Taba'ah Zat al-Salasil 1988) 246.

47. Ministry of Waqf and Islamic Affairs, *Al-Mawsu'ah al-Fiqhiyyah*, vol 5 (2 edn, Taba'ah Zat al-Salasil 1986) 246.
48. This is the view of the Hanafi and Hanbali schools of law. See *ibid* 246, 252-253.
49. This is the view of the Maliki and Shafi'i schools of law. See *ibid* 246, 252.
50. The Presidency of Islamic Researches Ifta Call and Guidance (ed), *The Holy Quran*, Al-Baqarah (2):280, 128.
51. Islamic Financial Services Act 2013 of Malaysia s 57 which provides, "The Bank may specify standards on prudential matters to promote (a) the sound financial position of an institution; or (b) integrity, professionalism and expertise in the conduct of the business, affairs and activities of an institution."
52. Bank Negara Malaysia, *Guidelines on Musharakah and Mudharabah Contracts for Islamic Banking Institutions* (n 42).
53. Islamic Financial Services Board, 'Guiding Principles of Risk Management for Institutions (Other Than Insurance Institutions) Offering Only Islamic Financial Services' ([www.ifsb.org](http://www.ifsb.org), 2005) <<http://www.ifsb.org/standard/ifsb1.pdf>> accessed 10 May 2014, see p 10, fn 7.
54. *ibid*, para 38.
55. *ibid*.
56. Usmani, *An Introduction to Islamic Finance* (n 36) 134.
57. It is known in Malay language as Agensi Kaunseling dan Pengurusan Kredit (AKPK).
58. Credit Caunselling and Debt Management Agency, 'About Us' (*Agensi Kaunseling dan Pengurusan Kredit (AKPK)*) <<http://www.akpk.org.my/about-us>> accessed 1 May 2014.
59. The tests are Financial Fitness Test and DMP Eligibility Test. See Credit Caunselling and Debt Management Agency, 'Evaluate Yourself' (*Agensi Kaunseling dan Pengurusan Kredit (AKPK)*) <<http://www.akpk.org.my/tools/EvaluateYourself/tabid/157/language/en-US/Default.aspx>> accessed 1 May 2014.
60. Credit Caunselling and Debt Management Agency, 'Success Stories: Story 7' (*Agensi Kaunseling dan Pengurusan Kredit (AKPK)*) <<http://www.akpk.org.my/learning/success-stories/id/40/story-7>> accessed 1 May 2014.

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